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SUBJECT: CHINA'S TEXTILE SUPPORT PLAN DISAPPOINTS

REF: Beijing 151

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¶1. (SBU) SUMMARY. On Feb. 4, the State Council's Standing Committee announced a support plan for the textile and garment industry, one of ten key industries to receive government support. The measures included lofty goals to expand domestic consumption, encourage industry consolidation and promote regional diversification. Textile manufacturers were disappointed at the single percentage-point increase in the VAT rebate for exports to 15 percent, seeing it as a symbolic rather than substantive move. Stock prices of major textile firms fell 3 to 5 percent on the Shanghai exchange the day after the announcement. Plan objectives include moving up the value-added spectrum with China's own patented products -- something which would require tougher domestic intellectual property right (IPR) enforcement. Details on a special fund to help "good firms" in financial difficulty remain to be clarified. END SUMMARY

¶2. (SBU) On Feb. 4, 2009, the State Council announced an industrial support plan for the textile and garment industry, one of ten key industries to receive such attention. (See reftel on auto/steel plans, reporting to follow on plan for machinery industry; other plans yet to be announced.) The textile plan sets very broad, and apparently long term goals to support both the domestic and export markets by growing domestic consumption, developing rural markets, promoting the application of textile products in industry, and diversifying export markets to stabilize international market shares.

¶3. (SBU) Specific measures will include: (1) promoting technology upgrades and the development of patented products; (2) accelerating elimination of outdated production capacity that conflicts with China's "jieneng, jianpai" (low energy consumption, low pollution) development objectives; (3) encouraging industry consolidation through mergers and acquisitions; (4)promoting regional development by encouraging coastal provinces to focus on high-tech, high value-added product and transferring low-end production to central and western provinces; (5) developing a production base in Xinjiang for high quality raw cotton and cotton textile products; and (6) providing financial support to textile and garment manufacturers by raising the VAT rebate on exports of textiles and garments by one percentage-point to 15 percent, and creating a special fund to be allocated to "good" enterprises which have temporarily suffered financial difficulties.

¶4. (SBU) Textiles and garments represent a key export sector and play a critical role in employing migrant labor, particularly in the Pearl River and Yangtze River delta regions around Guangzhou and Shanghai. The China National Textile and Apparel Council estimates over 20 million workers are employed in the industry, 80 percent of

which are migrant workers. But China's textile and garment exports grew only 8.2 percent in 2008 -- 10.7 percentage points lower than in 2007. China just welcomed the elimination of quotas to the U.S. with the expiration of the U.S.-China Memorandum of Understanding on Textile and Apparel Products on Dec. 31, 2008. A similar agreement with the E.U. expired at the end of 2007. This lifting of quotas combined with an appreciating Euro spurred exports to Europe in the first half of 2008. Demand from other developed markets, however, began to decline early in 2008.

¶5. (SBU) The 17 percent VAT rate on textiles was typically rebated when products were exported. In 2007, however, it was lowered to 11 percent to address concerns about growing trade friction. As the sector began to suffer in 2008, industry lobbied for the government to raise the VAT rebate rate. It was lifted to 13 percent on Aug. 1, 2008, and then to 14 percent on Nov. 1, 2008. The Feb. 4 support plan raises this by one additional percentage-point to 15 percent. Each time industry was disappointed that the increase was not larger. Following the announcement of the support plan, major textile firms fell on the Shanghai index, with Mongolia Eerduosi Cashmere Product Ltd., Huafang Textile Co., and Shanghai Dragon Co. dropping from between 3 to 5 percent.

¶6. (SBU) Many observers see the increase in the VAT rebate as a symbolic measure, since it is too small to impact producers. A large Guangdong manufacturer quoted in the Chinese press acknowledges the measure does nothing to address the drop in external demand that led to current difficulties. He fears that the tiny increase in VAT rebates will be eaten up by trading companies or foreign customers, who tend to have stronger bargaining power.

¶7. (SBU) Sun Huaibin, Director of the China Textile Economics

Research Center, says including textiles in the first four industries to received support demonstrates the government's strong concern for the sector. "Textiles have been hurting for nearly a year. Export demand from U.S. began dropping from early in 2008. The financial crisis in the U.S. last fall only accelerated the impact." Mr. Sun admits that the immediate financial benefit to firms from the plan will be limited, since most measures are long term. He believes his industry association will, however, play a role in helping develop criteria for determining which firms will receive financial support -- one of the least transparent provisions of the plan.

¶8. (SBU) COMMENT: The government's textile support plan measures do appear to be mostly symbolic, and offer minimal immediate relief. They include long-established, lofty development goals of transitioning industry to China's heartland, and increasing China's added value, stimulating innovation, reducing energy consumption and pollution, and consolidating industrial structure. But coastal provinces already losing jobs may not be so willing to see factories move, even those with low value add. Innovation and patentable technologies are a worthy goal, but unlikely to be realized given the current industry investment on R&D and of limited value without better IPR enforcement. Consolidation sounds nice, but the industry by nature is diversified and private firms play a large role -- it will not be as easy as in industries where state-owned firms dominate. As has been typical of these announcements, the policy is vague on the nature and application of the special fund for suffering enterprises. END COMMENT.

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